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No. 86-88

In The
Supreme Court of the United States
October Term, 1986

CITICORP INDUSTRIAL CREDIT, INC.,
Petitioner,

v.

WILLIAM E. BROCK, SECRETARY OF LABOR, UNITED STATES DEPARTMENT OF LABOR,
Respondent.

BRIEF OF NATIONAL COMMERCIAL FINANCE ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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INTEREST OF AMICUS

The National Commercial Finance Association ("NCFA") is a non-profit membership corporation organized under the laws of Delaware, with its principal office in New York.[1] NCFA is the national trade association for financial institutions that provide asset-based commercial financing and factoring. It has more than 230 members, including Petitioner Citicorp and substantially all of the major "money center" and regional banks, small commercial lenders, and large publicly-held commercial lenders.

Members of the NCFA operate on a national, regional and local scale, providing both operating funds and acquisition financing to businesses, often through the financing of accounts receivable and inventory on a revolving basis. Many of these businesses are small and medium-sized enterprises which depend upon the availability of secured financing for their existence and growth. For example, inventory financing may allow a borrower to purchase inventory needed for cyclical or seasonal build-ups or to supplement cash needs during periods of low volume. Similarly, secured acquisition financing in leveraged buyouts has played a major role in the decentralization and revitalization of many enterprises in relatively mature manufacturing industries, and the growth of new technology in modest-sized companies.[2]

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1 This Brief is filed with the consent of the parties; letters reflecting consent are on file with the Clerk.

2 *See generally* Dodsworth, *How Mr. Simon Opened The Floodgates; U.S. Leveraged Buyouts,* Financial Times, Dec.

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Secured financing has grown dramatically and has become a significant part of the national credit market. Total outstanding financing by the commercial finance and factoring industry has increased substantially in recent decades to more than $55 Billion in 1985.

As business people, the members of the NCFA expect to take risks on secured loans. They know that there is a danger of insolvency and sometimes fraud. They also know that their security interests will be inferior to earlier perfected liens and security interests. Before making their loans, therefore, secured lenders review the appropriate public records to determine the relative priority of their security interests in the collateral. This review permits them to consider the highly competitive market price for their loans and services in light of the risks of asset-based financing. The borrowers with whom they will do business and the structure and amount of the secured transaction turn, in large measure, on the established expectations resulting from notoriety of liens and security interests in the public record.

The Uniform Commercial Code provides the uniformity and certainty that are essential to the availability of modern secured lending, particularly to small businesses for which credit otherwise might be unavailable. More

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5, 1985 at 14 ("leveraged buyouts . . . have taken Wall Street by storm"); Williams, *Leveraged Buyouts Outpace Purchases By Private Concerns,* Wall St. J., Aug. 12, 1985 at 13, Col. 2; DeAngelo & DeAngelo, *The Numbers Show Everyone Profits,* N.Y. Times, Jan. 22, 1984 Section 3 at 2, Col. 2; Brown, *Leveraged Buyouts 1983's Rage,* Wash. Post, Dec. 7, 1983 at D8, Col. 3; Waters, *The Leveraged Buyout Boom,* Inc. Sept. 1983 at 46; *Why Leveraged Buyouts Are Getting So Hot,* Bus. Wk., June 27, 1983 at 86.

specifically, the Code permits commercial lenders to determine the risks associated with proposed loans from superior liens quickly and efficiently by checking public filings. In addition, the Code discourages secret encumbrances, while permitting flexible security devices designed to satisfy modern commercial needs. At least in part for these reasons, the Code has become a truly national law of commerce, adopted in 49 states, Puerto Rico, and the District of Columbia.

The Secretary's position, which has been adopted by the Sixth Circuit in direct and acknowledged conflict with settled precedent in the Second and Fourth Circuits, is that lenders with a security interest in inventory may be enjoined from foreclosing on their collateral under the "hot goods" provision of the Fair Labor Standards Act ("FLSA"), 15 U.S.C. § 215(a)(1), for violations of that Act by their borrowers. The Sixth Circuit's holding in this case will generate confusion and uncertainty in the secured lending industry and disrupt long-established commercial practice based on the Uniform Commercial Code. Furthermore, secured lenders who lend to borrowers with at least one facility in the Sixth Circuit (or any other jurisdiction except the Second or Fourth) will be forced to modify their advance ratios, interest rates or other loan terms to reflect the added risk to repayment of their loans introduced by the Sixth Circuit's decision. The result will be to tighten credit for borrowers or, in some cases, to make credit unavailable to enterprises that may be unable to obtain credit from any other source. Members of NCFA therefore will be directly and adversely affected by the Sixth Circuit's decision, and by the uncertainty that decision has created.

REASONS FOR GRANTING THE PETITION

I. THE CONFLICTING HOLDINGS OF THE COURTS OF APPEALS CREATE SUBSTANTIAL PRACTICAL PROBLEMS FOR THE COMMERCIAL LENDING INDUSTRY.

The Sixth Circuit acknowledged that its holding in this case conflicts with the holdings of both the Second Circuit in *Wirtz v. Powell Knitting Mills*, 360 F.2d 730 (2d Cir. 1966), and the Fourth Circuit in *Schultz v. Factors, Inc.*, 65 Lab. Cas. (CCH) ¶ 32,487 (4th Cir. 1971).[3] As the Second Circuit Court of Appeals pointed out in *Powell Knitting Mills, supra,* the position advanced by the Secretary of Labor in that action (as in this one), apparently was first conceived by the Secretary in the mid-1960's, "in spite of the myriad of instances in which similar security titles must have been enforced." 360 F.2d at 733. In the next reported decision, the Fourth Circuit was convinced by the "admirable clarity" of the *Powell Knitting Mills* decision, and rejected the Secretary's position. *Factors, supra,* at 44,732. The Secretary's first reported foray into the Sixth Circuit on this theory occurred in 1975. *Dunlop v. Sportsmaster, Inc.*, 77 Lab. Cas. ¶ 33,293 (E.D. Tenn. 1975). Once again, the court rejected the Secretary's theory.

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[3] In *Powell Knitting Mills,* the Second Circuit adopted "a rule that frees from Section 15 only a creditor foreclosing like Meinhard, for nonpayment of funds previously advanced." 360 F.2d at 732. The Sixth Circuit majority states that "Although we are reluctant to create an inter-circuit conflict, we cannot agree with the Second Circuit's judicially created exception." Pet. App. 9a. The Sixth Circuit majority concludes as follows: "We therefore, reject the reasoning in *Powell Knitting Mills* and hold that 29 U.S.C. Section 215(a)(1) applies to secured creditors." Pet. App. 12a.

In the decades during which the Secretary unsuccessfully sought judicial approval of his interpretation of § 15(a)(1), commercial lenders reasonably relied on settled law in structuring their transactions. Now that the Secretary has received judicial support for his position, however, there is every reason to assume that the Secretary will seek to implement and extend this ruling in other circuits. *See, e.g.,* Pet. App. 9a n.8. Many opportunities for the Secretary to test his theory in other circuits necessarily will arise, since virtually every failed business that has relied on secured credit will leave some employees who have not been paid all of their final wages.

As Judge Engel's dissent points out, *see* Pet. App. 15a, the "uniform national construction of the Act," which has been in effect for nearly 20 years, has been destroyed. This is not a case involving a newly adopted law, where the reliance interests are minimal and judicial consideration has been limited. The Sixth Circuit's decision destroys the highly desirable national uniformity regarding § 15(a)(1), and introduces an entirely new, revolutionary reading of the provision. The impact of overturning a rule of law that has been "uniformly held . . . over a long period of time," *id.* at 16a, is far more significant than the impact of rejecting the first tentative constructions of a new statute. These circumstances weigh heavily in favor of immediate consideration by this Court.

Furthermore, there is a very real threat of unfair forum shopping by the Department of Labor. Many borrowers conduct operations and maintain inventory in multiple states. To the extent any of the borrowers' operations are located in the Sixth Circuit, the Secretary is likely to bring an enforcement action in the Sixth Circuit, seeking, how-

ever, to restrain the sale or movement of *all* of the inventory, wherever located.

In addition, the risks to secured lenders inherent in litigation delay are significant, even if all of the courts outside the Sixth Circuit eventually reject the Secretary's novel theory. A secured lender has a strong interest in liquidating his collateral promptly, particularly if the collateral may be insufficient to permit recovery of both principal and interest on the outstanding debt, or if the collateral is either perishable or seasonal in nature. If the collateral is insufficient, the lender will be denied the use of his funds and the interest that could be earned on those funds while litigation is pending. If the collateral is perishable or seasonal, there is a risk that it will become worthless before formal proceedings can be concluded. Thus, frequently the threat of litigation and the possibility that the Sixth Circuit's interpretation of Section 15(a)(1) may be adopted will be sufficient to force capitulation by the creditor without litigation. However frequently the issue arises, therefore, the Secretary's distortion of the "hot goods" provision may receive only random and intermittent judicial scrutiny, even at the district court level; litigation that does arise may seldom reach an appellate court.[4]

Accordingly, the conflict is one whose continued existence can no longer be tolerated. It must be resolved now, before it causes further mischief.

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[4] *See* C.A. App. 66 (counsel for the Secretary explained: "Your Honor, there's not much case law, as TROs have been issued, usually, and after they are issued parties get together, pay everybody, and [the case] never goes any farther than that.")

II. THE RULE ADOPTED BY THE SIXTH CIRCUIT WILL DISCOURAGE SECURED LENDING.

In his dissent below Judge Engel stated that, "The need for a uniform national construction of the Act is obvious." 788 F.2d at 1207. Because of the Sixth Circuit's decision, the many NCFA members who do business on a national or regional scale must consider reducing loan availability or increasing interest rates, even on loans secured in large part by inventory outside the Sixth Circuit. A lender making loans to a debtor with a manufacturing plant in New York (Second Circuit) and a warehouse in Ohio (Sixth Circuit) must assume for purposes of credit risk analysis that the Secretary would bring any action under § 15(a)(1) of the FLSA in the Sixth Circuit, and must therefore reduce its lending availability formula on *all* of the inventory collateral, wherever located. When lenders can predict that this new "secret lien" may be invoked, the availability of credit will be lessened as the advance rate against inventory is reduced or, in some cases, no inventory loans will be made.

In circuits other than the Second, Fourth or Sixth Circuits there is a new and meaningful uncertainty as to the value of inventory as collateral. Prior to this ruling, most secured lenders justifiably assumed that sales of their inventory collateral were not subject to injunction under the FLSA. This assumption is no longer reliable outside of the Sixth Circuit. Such uncertainty for those engaged in national financial transactions is directly contrary to the important policies recognized by this Court

in *United States v. Kimbell Foods, Inc.*, 440 U.S. 715, 739-740 (1979).[5]

There can be no doubt about how often this new federal "lien" could be invoked. In an era where failed ventures are common, it is equally common to find unpaid employees at the time a business terminates due to insolvency. The Secretary's new weapon, if allowed to persist, will be a serious disruptive element in the commercial lending industry, which now in the Sixth Circuit is apparently required to assist the Secretary in enforcing compliance with the FLSA.

Commercial lenders place a high priority upon predictability and uniformity of legal consequences in determining how much credit to extend, and what advance rates to employ in managing that credit, particularly in transactions with a borrower having multi-state or national operations. For borrowers without easy access to the credit markets, such as most small or medium-sized companies, the uncertainty brought about by the conflict between the circuits may discourage a secured lender from extending credit. This uncertainty and unpredictability normally will require larger loan reserves, reducing the amount of credit available to the borrower.

Another consequence of the Sixth Circuit's ruling is to cause a secured lender with inventory collateral to pro-

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[5] "In structuring financial transactions, businessmen depend on state commercial law to provide the stability essential for reliable evaluation of the risks involved. . . .

"Because the ultimate consequences of altering settled commercial practices are so difficult to foresee, we hesitate to create new uncertainties, in the absence of careful legislative deliberations."

tect itself against possible loss of collateral at least equal to wages for several pay periods of its borrowers. Borrowers in poor financial condition probably will not find credit available to continue operations. This will precipitate, in some cases, repayment demands for loans, earlier closing of businesses and earlier termination of employment in businesses that might otherwise have survived.

The Sixth Circuit assumed that its decision would require secured lenders to exercise a greater amount of supervision over the operations of their borrowers to assure that wage payments are made. *See, e.g.*, Pet. App. 24a. This proposed role for secured creditors is not feasible or prudent, and presents a variety of serious business and legal problems. In an ordinary case of an insolvent borrower, a secured creditor has no knowledge whether workers are, or are not, being paid on a current basis, and could not assure such payments except by making loans in excess of normal availability, and by keeping its own auditors on the borrower's premises. Prospective borrowers would not be interested in arrangements with a lender that proposes to monitor and interfere with the operation of their businesses; secured lenders would not be interested in risking claims that they had thereby exercised dominion and control over their borrowers that could result in a loss of their security interests or a finding that they should be equitably subordinated to the rights of other creditors.[6]

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[6] *See Taylor v. Standard Gas & Electric Company*, 306 U.S. 307 (1939); *In re Process-Manz Press*, 236 F. Supp. 333 (N.D. Ill. 1964), *rev'd on jurisdictional grounds*, 369 F.2d 513 (7th Cir. 1966), *cert. denied sub nom Limperis v. A.J. Armstrong Co.*, 386 U.S. 957 (1967); A. DeNatale and P. Abram, *The Doctrine of Equitable Subordination as Applied to Non-Managerment Creditors*, 40 Business Lawyer 417, 432-445 (1985).

III. ENFORCING SECTION 15(a)(1) AGAINST THE INTERESTS OF SECURED LENDERS DOES NOT FURTHER THE PURPOSE OR POLICY OF THE FLSA.

In *Powell Knitting Mills,* the Second Circuit recognized that, in making unlawful the sale of goods produced in violation of the FLSA, Congress provided some protection from unfair competition to businesses that "complied with the Act." 360 F.2d at 732. Because the debtor in *Powell Knitting* was insolvent, the Court correctly noted that there could be no adverse competitive effects when sale of the goods is accomplished by a foreclosing secured creditor, who sells the goods at a price determined without consideration of their cost of production.[7] In this function, the secured lender's role is similar to that of a trustee liquidating a bankrupt estate, often at prices below cost.

The Second Circuit also recognized that Section 15(a)(1) operated to provide some assurance that wage earners would get paid. 360 F.2d at 733. With an insolvent debtor, however, the only way unpaid employees can be paid is by taking money away from other creditors, including secured creditors. As the Second Circuit noted, "without some reasonably clear reference to the problem in the Act or in its history we find it hard to believe that Congress contemplated that the foreclosing creditor would have to pay the wage earners to avoid § 15." *Id.*

The Sixth Circuit states incorrectly and simplistically that one purpose of the FLSA "is to keep goods that were produced in violation of the FLSA out of interstate commerce." 788 F.2d at 1203. Rather, Section 15(a)(1) is one of several means to accomplish the purposes of the Act; keeping goods produced in violation of the Act out of interstate commerce is not an independent purpose of the FLSA. In any event, as noted by Judge Engel in his dissent, the goods will usually enter interstate commerce even if, as here, the Secretary obtains an injunction. "[A]lmost always the result will be that the goods are sold, if not in foreclosure, then in bankruptcy, or by other attaching creditors." 788 F.2d at 1207. If the goods do not enter commerce, it likely will be because the amount of unpaid wages exceeds the value of the goods, in which event the goods will be abandoned or destroyed, and the employees will not be paid. The Secretary can hardly contend that that result would fulfill any purpose of the FLSA.

[7] *See* Samuelson, *Economics* at 380 (8th ed. 1970) ("Once a bridge is built it must earn what the traffic will bear regardless of past sunk costs."); McConnell, *Economics* at 472-73 (9th ed. 1984).

Further, the Secretary's interpretation of Section 15(a)(1) ignores several fundamental precepts of statutory construction. In the oft-cited case of *Church of the Holy Trinity v. United States,* 143 U.S. 457 (1892), this Court stated:

> It is a familiar rule that a thing may be within the letter of the statute and yet not within the statute because not within its spirit, nor within the intention of its makers.

143 U.S. at 459, *quoted in United Steelworkers of America v. Weber,* 443 U.S. 193, 201 (1979).[8] Absent compelling

[8] *See Lynch v. Overholser,* 369 U.S. 705, 710 (1962) (The Court has "repeatedly warned against the dangers of an approach to statutory construction which confines itself to

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evidence that Congress intended to require secured creditors to pay the wages of the employees of their borrowers, or at least that Congress's purpose would be served by such a dramatic change in the law, the Secretary's theory should be rejected. To apply § 15(a)(1) to impair valid perfected security interests in inventory with no evidence of lender wrongdoing would not serve the purpose of the FLSA. This Court should grant the petition, endorse the reasoning of the Second and Fourth Circuits, and reverse the Sixth Circuit's decision.

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the bare words of a statute . . . for 'literalness may strangle meaning.' ") (quoting *Utah Junk Co. v. Porter,* 328 U.S. 39, 44 (1946)); *United States v. American Trucking Associations,* 310 U.S. 534, 543-44 (1940) ("When aid to construction of the meaning of words, as used in the statute, is available, there certainly can be no 'rule of law' which forbids its use, however clear the words may appear on 'superficial examination.' "); *Ozawa v. United States,* 260 U.S. 178, 194 (1922) (Court should give effect to statute "in accordance with its design and purpose, sacrificing, if necessary, the literal meaning in order that the purpose may not fail."); *American Tobacco Co. v. Werckmeister,* 207 U.S. 284, 293 (1907) ("But in construing a statute, we are not always confined to a literal reading . . ."); C. Sands, 2A *Sutherland Statutory Construction,* §§ 45.09, 46.01 at 40, 73 (5th Ed. 1984); R. Posner, *Statutory Intepretation—In the Classroom And In the Courtroom,* 50 U. Chi. L. Rev. 800 (1983); A. Murphy, *Old Maxims Never Die: The "Plain Meaning Rule" And Statutory Interpretation In The "Modern" Federal Courts,* 75 Colum. L. Rev. 1299 (1975).

CONCLUSION

For the foregoing reasons, Citicorp's petition for a writ of certiorari to the Sixth Circuit should be granted.

Respectfully submitted,

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